

ASSEMBLY BILL

No. 628

Introduced by Assembly Member Runner

February 19, 2003

An act to amend Sections 18662 and 18668 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 628, as introduced, Runner. Taxation: sale of real property interest: withholding requirements.

Existing law requires the transferee of real property to withhold 3¹/₃% of the purchase price of the property if the property was either acquired from a person or from a corporation, if that corporation after the transfer has no permanent place of business in this state.

This bill, for taxable years beginning on or after January 1, 2004, would modify the application of this withholding requirement to provide that a sale of real property interest acquired from an individual is exempt from withholding, if the individual is a sole proprietor engaged in a trade or business of the construction and sale of residential houses, and the real property interest, prior to the transfer, was held by the individual primarily for sale to customers in the ordinary course of the transferor's trade or business.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 18662 of the Revenue and Taxation
- 2 Code is amended to read:

1 18662. (a) The Franchise Tax Board may, by regulation,
2 require any person, in whatever capacity acting (including lessees
3 or mortgagors of real or personal property, fiduciaries, employers,
4 and any officer or department of the state or any political
5 subdivision or agency of the state, or any city organized under a
6 freeholder's charter, or any political body not a subdivision or
7 agency of the state), having the control, receipt, custody, disposal,
8 or payment of items of income specified in subdivision (b), to
9 withhold an amount, determined by the Franchise Tax Board to
10 reasonably represent the amount of tax due when the items of
11 income are included with other income of the taxpayer, and to
12 transmit the amount withheld to the Franchise Tax Board at the
13 time as it may designate.

14 (b) The items of income referred to in subdivision (a) are
15 interest, dividends, rents, prizes and winnings, premiums,
16 annuities, emoluments, compensation for services, including
17 bonuses, partnership income or gains, and other fixed or
18 determinable annual or periodical gains, profits, and income.

19 (c) The Franchise Tax Board may authorize the tax under
20 subdivision (a) to be deducted and withheld from the interest upon
21 any securities the owners of which are not known to the
22 withholding agent.

23 (d) Any person failing to withhold from any payments any
24 amounts required by subdivision (a) to be withheld is liable for the
25 amount withheld or the amount of taxes due from the person to
26 whom the payments are made to an extent not in excess of the
27 amounts required to be withheld, whichever is greater, unless it is
28 shown that the failure to withhold is due to reasonable cause.

29 (e) (1) In the case of any disposition of a California real
30 property interest by an individual, the transferee (including for this
31 purpose any intermediary or accommodator in a deferred
32 exchange) ~~shall be~~ is required to withhold an amount equal to $3\frac{1}{3}$
33 percent of the sales price of the California real property conveyed.

34 (2) Notwithstanding any other provision of this subdivision, all
35 of the following ~~shall~~ apply:

36 (A) No transferee ~~shall be~~ is required to withhold any amount
37 under this subdivision unless the sales price of the California real
38 property conveyed exceeds one hundred thousand dollars
39 (\$100,000).

1 (B) No transferee (other than an intermediary or an
2 accommodator in a deferred exchange) ~~shall be~~ *is* required to
3 withhold any amount under this subdivision unless written
4 notification of the withholding requirements of this subdivision
5 has been provided by the real estate escrow person.

6 (C) No transferee ~~shall be~~ *is* required to withhold under this
7 subdivision when the transferee is a corporate beneficiary under
8 a mortgage or beneficiary under a deed of trust and the California
9 real property is acquired in judicial or nonjudicial foreclosure or
10 by a deed in lieu of foreclosure.

11 (D) No transferee ~~shall be~~ *is* required to withhold any amount
12 under this subdivision if the transferee, in good faith and based
13 upon all the information of which he or she has knowledge, relies
14 on a written certificate executed by the transferor, certifying under
15 penalty of perjury, that the California real property being
16 conveyed is the principal residence of the transferor (within the
17 meaning of Section 121 of the Internal Revenue Code).

18 (E) (i) No transferee (including for this purpose any
19 intermediary or accommodator in a deferred exchange) ~~shall be~~ *is*
20 required to withhold any amount under this subdivision if the
21 transferee, in good faith and based on all the information of which
22 he or she has knowledge, relies on a written certificate executed by
23 the transferor, certifying under penalty of perjury, that the
24 California real property being conveyed is exchanged, or will be
25 exchanged, for property of like kind (within the meaning of
26 Section 1031 of the Internal Revenue Code), but only to the extent
27 of the amount of the gain not required to be recognized for
28 California income tax purposes under Section 1031 of the Internal
29 Revenue Code.

30 (ii) Clause (i) ~~shall~~ *does* not apply to the extent that any
31 exchange does not qualify for nonrecognition treatment for
32 California income tax purposes under Section 1031 of the Internal
33 Revenue Code, in whole or in part, due to the failure of the
34 transaction to comply with the provisions of Section 1031(a)(3) of
35 the Internal Revenue Code, relating to requirement that property
36 be identified and that exchange be completed not more than 180
37 days after transfer of the exchanged property.

38 (iii) In any case where clause (ii) applies, the transferee
39 (including for this purpose any intermediary or accommodator in
40 a deferred exchange) shall be required to notify the Franchise Tax

1 Board in writing within 10 days of the expiration of the statutory
2 periods specified in Section 1031(a)(3) of the Internal Revenue
3 Code and shall thereafter remit the applicable withholding
4 amounts determined under this subdivision in accordance with
5 paragraph (4).

6 (F) No transferee ~~shall be~~ is required to withhold any amount
7 under this subdivision if the transferee, in good faith and based on
8 all the information of which he or she has knowledge, relies on a
9 written certificate executed by the transferor, certifying under
10 penalty of perjury, that the California real property has been
11 compulsorily or involuntarily converted (within the meaning of
12 Section 1033 of the Internal Revenue Code) and that the transferor
13 intends to acquire property similar or related in service or use so
14 as to be eligible for nonrecognition of gain for California income
15 tax purposes under Section 1033 of the Internal Revenue Code.

16 (G) No transferee ~~shall be~~ is required to withhold any amount
17 under this subdivision if the transferee, in good faith and based on
18 all the information which he or she has knowledge, relies on a
19 written certificate executed by the transferor, certifying under
20 penalty of perjury, that the transaction will result in a loss for
21 California income tax purposes.

22 (H) *No transferee is required to withhold any amount under this*
23 *subdivision if the transferor (i) is an individual who is a sole*
24 *proprietor engaged in a trade or business of the construction and*
25 *sale of residential houses and (ii) the real property interest, prior*
26 *to the transfer, was held by the transferor primarily for sale to*
27 *customers in the ordinary course of the transferor's trade or*
28 *business.*

29 (3) (A) In the case of any transaction otherwise subject to this
30 subdivision that qualifies as an “installment sale” (within the
31 meaning of Section 453(b) of the Internal Revenue Code) for
32 California income tax purposes, the provisions of this subdivision
33 may, upon the irrevocable written election of the transferee, be
34 separately applied to each payment to be made under the terms of
35 the installment sale agreement between the parties.

36 (B) For purposes of subparagraph (A), subparagraph (A) of
37 paragraph (2) shall not apply to each individual payment to be
38 received under the terms of the installment sale agreement.

39 (C) The election under this paragraph shall be made at the time,
40 and in the form and manner, specified by the Franchise Tax Board

1 in forms and instructions, except that the form shall, at a minimum,
2 include the requirement specified in subparagraph (D) of this
3 paragraph.

4 (D) The election under this paragraph shall only be valid if the
5 transferee agrees to withhold and remit from each installment
6 payment the amount specified under this subdivision in the form
7 and manner, and at the time, specified in paragraph (4).

8 (4) Amounts withheld and payments made in accordance with
9 this subdivision shall be reported and remitted to the Franchise Tax
10 Board in the form and manner and at the time specified by the
11 Franchise Tax Board.

12 (5) For purposes of this subdivision, “California real property
13 interest” means an interest in real property located in California
14 and defined in Section 897(c)(1)(A)(i) of the Internal Revenue
15 Code.

16 (6) For purposes of this subdivision, “real estate escrow
17 person” means any of the following persons involved in the real
18 estate transaction:

19 (A) The person (including any attorney, escrow company, or
20 title company) responsible for closing the transaction.

21 (B) If no other person described in subparagraph (A) is
22 responsible for closing the transaction, then any other person who
23 receives and disburses the consideration or value for the interest
24 or property conveyed.

25 (7) (A) Unless the real estate escrow person provides
26 “assistance,” it shall be unlawful for any real estate escrow person
27 to charge any customer for complying with the requirements of
28 this subdivision.

29 (B) For purposes of this paragraph, “assistance” includes, but
30 is not limited to, helping the parties clarify with the Franchise Tax
31 Board the issue of whether withholding is required under this
32 subdivision or, upon request of the parties, withholding an amount
33 under this subdivision and remitting that amount to the Franchise
34 Tax Board.

35 (C) For purposes of this paragraph, “assistance” does not
36 include providing the written notification of the withholding
37 requirements of this subdivision.

38 (D) In a case where the real estate escrow person provides
39 “assistance” in complying with the withholding requirements of
40 this subdivision, it shall be unlawful for the real estate escrow

1 person to charge any customer a fee that exceeds forty-five dollars
2 (\$45).

3 (8) For purposes of this subdivision, “sales price” means the
4 sum of all of the following:

5 (A) The cash paid, or to be paid, but excluding for this purpose
6 any stated or unstated interest or original issue discount (as
7 determined under Sections 1271 through 1275, inclusive, of the
8 Internal Revenue Code).

9 (B) The fair market value of other property transferred, or to be
10 transferred.

11 (C) The outstanding amount of any liability assumed by the
12 transferee or to which the California real property interest is
13 subject immediately before and after the transfer.

14 (f) (1) In the case of any disposition of a California real
15 property interest by a person (but not a partnership as determined
16 in accordance with Subchapter K of Chapter 1 of Subtitle A of the
17 Internal Revenue Code, or a corporation, or an individual), when
18 the return required to be filed with the Secretary of the Treasury
19 under Section 6045(e) of the Internal Revenue Code indicates, or
20 the authorization for the disbursement of the transaction’s funds
21 instructs, that the funds be disbursed either to a transferor with a
22 last known street address outside the boundaries of this state at the
23 time of the transfer of the title to the California real property or to
24 the financial intermediary of the transferor, the transferee shall be
25 required to withhold an amount equal to $3\frac{1}{3}$ percent of the sales
26 price of the California real property conveyed.

27 (2) In the case of any disposition of a California real property
28 interest by a corporation, the transferee ~~shall be~~ is required to
29 withhold an amount equal to $3\frac{1}{3}$ percent of the sales price of the
30 California real property conveyed, if the corporation immediately
31 after the transfer of the title to the California real property has no
32 permanent place of business in California. For purposes of this
33 subdivision, a corporation has no permanent place of business in
34 California if all of the following apply:

35 (A) It is not organized and existing under the laws of
36 California.

37 (B) It does not qualify with the office of the Secretary of State
38 to transact business in California.

39 (C) It does not maintain and staff a permanent office in
40 California.



(3) Notwithstanding any other provision of this subdivision, all of the following shall apply:

(A) No transferee ~~shall be~~ is required to withhold any amount under this subdivision if the sales price of the California real property conveyed does not exceed one hundred thousand dollars (\$100,000).

(B) No transferee ~~shall be~~ is required to withhold any amount under this subdivision unless written notification of the withholding requirements of this subdivision has been provided by the real estate escrow person.

(C) No transferee ~~shall be~~ is required to withhold under this subdivision when the transferor is a bank acting as trustee other than a trustee of a deed of trust.

(D) No transferee ~~shall be~~ is required to withhold under this subdivision when the transferee is a corporate beneficiary under a mortgage or beneficiary under a deed of trust and the California real property is acquired in judicial or nonjudicial foreclosure or by a deed in lieu of foreclosure.

(E) No transferee ~~shall be~~ is required to withhold any amount under this subdivision if the transferee, in good faith and based on all the information of which he or she has knowledge, relies on a written certificate executed by the transferor, certifying under penalty of perjury that the transferor is a corporation with a permanent place of business in California.

(4) (A) At the request of the transferor, the Franchise Tax Board may authorize that a reduced amount or no amount be withheld under this subdivision if the Franchise Tax Board determines that to substitute a reduced amount or no amount shall not jeopardize the collection of tax imposed by Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). If the transferor provides documentation sufficient for the Franchise Tax Board to determine the actual gain required to be recognized on the transaction, the Franchise Tax Board may authorize a reduced amount based on the amount of the gain, as determined, which will result in a sum which is substantially equivalent to the amount of tax reasonably estimated to be due under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) from the inclusion of the gain in the gross amount of the transferor.

1 (B) Within 45 days after receiving a request that a reduced
2 amount or no amount be withheld, the Franchise Tax Board shall
3 either authorize a reduced amount or no amount, or deny the
4 request.

5 (C) In the case where the parties to the transaction are
6 requesting that a reduced amount or no amount be withheld and the
7 response by the Franchise Tax Board to the request has not been
8 received at the time title to the California real property is
9 transferred, the parties may direct the real estate escrow person to
10 hold in trust for 45 days the amount required to be withheld under
11 this subdivision. The parties shall instruct the real estate escrow
12 person that at the end of 45 days the real estate escrow person shall
13 remit the amount withheld to the Franchise Tax Board in
14 accordance with this section, unless the Franchise Tax Board has
15 authorized that a reduced amount or no amount be withheld.

16 (5) Amounts withheld and payments made in accordance with
17 this subdivision shall be reported and remitted to the Franchise Tax
18 Board in the form and at the time as the Franchise Tax Board shall
19 determine.

20 (6) “California real property interest” means an interest in real
21 property located in California and defined in Section
22 897(c)(1)(A)(i) of the Internal Revenue Code.

23 (7) For purposes of this subdivision, “financial intermediary”
24 means an agent for the purpose of receiving and transferring funds
25 to a principal.

26 (8) For purposes of this subdivision, “real estate escrow
27 person” means any of the following persons involved in the real
28 estate transaction:

29 (A) The person (including any attorney, escrow company, or
30 title company) responsible for closing the transaction.

31 (B) If no other person described in subparagraph (A) is
32 responsible for closing the transaction, then any other person who
33 receives and disburses the consideration or value for the interest
34 or property conveyed.

35 (9) (A) Unless the real estate escrow person provides
36 “assistance,” it shall be unlawful for any real estate escrow person
37 to charge any customer for complying with the requirements of
38 this subdivision.

39 (B) For purposes of this paragraph, “assistance” includes, but
40 is not limited to, helping the parties clarify with the Franchise Tax

Board the issue of whether withholding is required under this subdivision, helping the parties request that the Franchise Tax Board authorize a reduced amount or no amount be withheld under this subdivision, or, upon request of the parties, withholding an amount under this subdivision and remitting the amount to the Franchise Tax Board.

(C) For purposes of this paragraph, “assistance” does not include providing the written notification of the withholding requirements of this subdivision, or providing the certification that the transferor is a corporation with a permanent place of business in California.

(D) In a case where the real estate escrow person provides “assistance” in complying with the withholding requirements of this subdivision, it shall be unlawful for the real estate escrow person to charge any customer a fee that exceeds forty-five dollars (\$45).

(10) For purposes of this subdivision, “sales price” means the sum of all of the following:

(A) The cash paid, or to be paid. The term “cash paid, or to be paid” does not include stated or unstated interest or original issue discount (as determined by Sections 1271 to 1275, inclusive, of the Internal Revenue Code).

(B) The fair market value of other property transferred, or to be transferred.

(C) The outstanding amount of any liability assumed by the transferee or to which the California real property interest is subject immediately before and after the transfer.

(g) Whenever any person has withheld any amount pursuant to this section, the amount so withheld shall be held in trust for the State of California. The amount of the fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

(h) Withholding ~~shall~~ *may* not be required under this section with respect to wages, salaries, fees, or other compensation paid by a corporation for services performed in California for that corporation to a nonresident corporate director for director services, including attendance at a board of directors’ meeting.

(i) In the case of any payment described in subdivision (h), the person making the payment shall do each of the following:

(1) File a return with the Franchise Tax Board at the time and in the form and manner specified by the Franchise Tax Board.

(2) Provide the payee with a statement at the time and in the form and manner specified by the Franchise Tax Board.

(j) (1) The amendments to this section made by the act adding this subdivision shall only apply to dispositions of California real property interests that occur on or after January 1, 2003.

(2) In the case of any payments received on or after January 1, 2003, pursuant to an installment sale agreement relating to a disposition occurring before January 1, 2003, the amendments to this section made by the act adding this subdivision shall not apply to those payments.

(k) *The changes make to this section by the act adding this subdivision apply to a disposition of California real property interest that occur on or after January 1, 2004.*

SEC. 2. Section 18668 of the Revenue and Taxation Code is amended to read:

18668. (a) Every person required under this article to deduct and withhold any tax is hereby made liable for that tax, to the extent provided by this section and, insofar as they are not inconsistent with this article, all the provisions of this part relating to penalties, interest, assessment, and collections shall apply to persons subject to this part, and for these purposes any amount required to be deducted and paid to the Franchise Tax Board under this article shall be considered the tax of the person. Any person who fails to withhold from any payments any amount required to be withheld under this article is liable for the amount withheld or the amount of taxes due from the taxpayer to whom the payments are made but not in excess of the amount required to be withheld, whichever is more, unless it is shown that the failure to withhold is due to reasonable cause.

(b) If any amount required to be withheld under this article is not paid to the Franchise Tax Board on or before the due date required by regulations, interest shall be assessed at the adjusted annual rate established pursuant to Section 19521, computed from the due date to the date paid.

(c) Whenever any person has withheld any amount pursuant to this article, the amount so withheld shall be held to be a special fund in trust for the State of California.

(d) In lieu of the amount provided for in subdivision (a), unless it is shown that the failure to withhold is due to reasonable cause, whenever any transferee is required to withhold any amount pursuant to subdivision (e) or (f) of Section 18662, the transferee is liable for the greater of the following amounts for failure to withhold only after the transferee, as specified, is notified in writing of the requirements under subdivision (e) or (f) of Section 18662:

(1) Five hundred dollars (\$500).

(2) Ten percent of the amount required to be withheld under subdivision (e) or (f) of Section 18662.

(e) (1) Unless it is shown that the failure to notify is due to reasonable cause, the real estate escrow person shall be liable for the amount specified in subdivision (d), when written notification of the withholding requirements of subdivision (e) or (f) of Section 18662 is not provided to the transferee (other than a transferee that is an intermediary or accommodator in a deferred exchange) and the California real property disposition is subject to withholding under subdivision (e) or (f) of Section 18662.

(2) The real estate escrow person shall provide written notification to the transferee (other than a transferee that is an intermediary or accommodator in a deferred exchange) in substantially the same form as follows:

“In accordance with Section 18662 of the Revenue and Taxation Code, a buyer may be required to withhold an amount equal to $3\frac{1}{3}$ percent of the sales price in the case of a disposition of California real property interest by either:

1. A seller who is an individual, *other than a sole proprietor who is engaged in a trade or business of the construction and sale of residential houses and who held the real property interest, prior to the transfer, primarily for sale to customers in his or her ordinary trade or business*, or when the disbursement instructions authorize the proceeds to be sent to a financial intermediary of the seller, OR

2. A corporate seller that has no permanent place of business in California.

1 The buyer may become subject to penalty for failure to withhold
2 an amount equal to the greater of 10 percent of the amount required
3 to be withheld or five hundred dollars (\$500).

4 However, notwithstanding any other provision included in the
5 California statutes referenced above, no buyer will be required to
6 withhold any amount or be subject to penalty for failure to
7 withhold if:

8 1. The sales price of the California real property conveyed does
9 not exceed one hundred thousand dollars (\$100,000), OR

10 2. The seller executes a written certificate, under the penalty of
11 perjury, certifying that the seller is a corporation with a permanent
12 place of business in California, OR

13 3. The seller, who is an individual, executes a written
14 certificate, under the penalty of perjury, of any of the following:

15 A. That the California real property being conveyed is the
16 seller's principal residence (within the meaning of Section 121 of
17 the Internal Revenue Code).

18 B. That the California real property being conveyed is or will
19 be exchanged for property of like kind (within the meaning of
20 Section 1031 of the Internal Revenue Code), but only to the extent
21 of the amount of gain not required to be recognized for California
22 income tax purposes under Section 1031 of the Internal Revenue
23 Code.

24 C. That the California real property has been compulsorily or
25 involuntarily converted (within the meaning of Section 1033 of the
26 Internal Revenue Code) and that the seller intends to acquire
27 property similar or related in service or use so as to be eligible for
28 nonrecognition of gain for California income tax purposes under
29 Section 1033 of the Internal Revenue Code.

30 D. That the California real property transaction will result in a
31 loss for California income tax purposes.

32 The seller is subject to penalty for knowingly filing a fraudulent
33 certificate for the purpose of avoiding the withholding
34 requirement.

35 The California statutes referenced above include provisions
36 which authorize the Franchise Tax Board to grant reduced
37 withholding and waivers from withholding on a case-by-case basis
38 for corporations or other entities.
39

1 (3) The real estate escrow person ~~shall not~~ *is not* be liable under
2 this subdivision, if the tax due as a result of the disposition of
3 California real property is paid by the original or extended due date
4 of the transferor's return for the taxable year in which the
5 disposition occurred.

6 (4) The real estate escrow person and the transferee shall not be
7 liable under paragraph (1) or subdivision (d), if the failure to
8 withhold is the result of the real estate escrow person's reliance,
9 based on good faith and on all the information of which he or she
10 has knowledge, upon a written certificate executed by the
11 transferor under penalty of perjury certifying to any of the
12 following:

13 (A) Where the transferor is an individual:

14 (i) That the California real property being conveyed is the
15 principal residence of the transferor within the meaning of Section
16 121 of the Internal Revenue Code.

17 (ii) That the California real property being conveyed is or will
18 be exchanged for property of like kind within the meaning of
19 Section 1031 of the Internal Revenue Code, but only to the extent
20 of the amount of gain not required to be recognized for California
21 income tax purposes under Section 1031 of the Internal Revenue
22 Code.

23 (iii) That the California real property has been compulsorily or
24 involuntarily converted, within the meaning of Section 1033 of the
25 Internal Revenue Code, and that the seller intends to acquire
26 property similar or related in service or use so as to be eligible for
27 nonrecognition of gain for California income tax purposes under
28 Section 1033 of the Internal Revenue Code.

29 (iv) That the California real property transaction will result in
30 a loss for California income tax purposes.

31 (B) Where the transferor is a corporation, that the transferor is
32 a corporation with a permanent place of business in California.

33 (5) Any transferor who for the purpose of avoiding the
34 withholding requirements of subdivision (e) or (f) of Section
35 18662 knowingly executes a false certificate pursuant to this
36 subdivision shall be liable for twice the amount specified in
37 subdivision (d).

38 (6) Unless the failure to notify is due to willful disregard of the
39 withholding requirements of subdivision (e) or (f) of Section
40 18662, the real estate escrow person shall not be liable under this

1 subdivision if the disposition of California real property occurs
2 prior to July 1, 1991.

3 (f) The amount of tax required to be deducted and withheld
4 under this article shall be assessed, collected, and paid in the same
5 manner and subject to the same provisions and limitations
6 (including penalties) as are applicable with respect to the taxes
7 imposed by Part 10 (commencing with Section 17001) or Part 11
8 (commencing with Section 23001).

9 (g) *The changes made to this section by the act adding this*
10 *subdivision apply to dispositions of real property interest that*
11 *occur on or after January 1, 2004.*

